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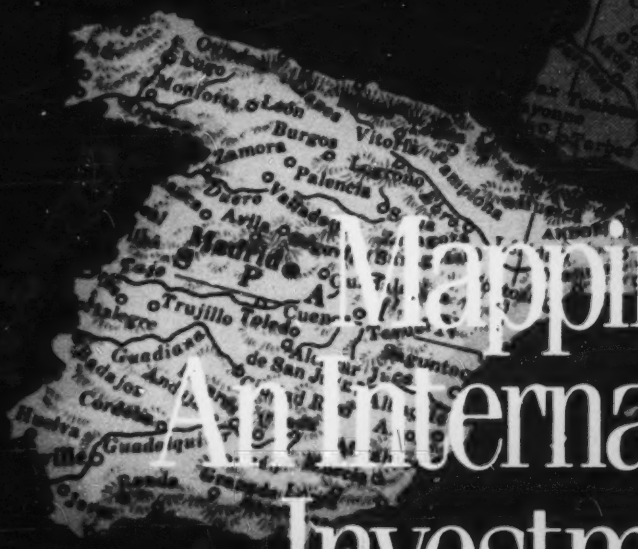
# PENSION WORLD

Investment Managers • Plan Sponsors • Employee Benefits

April 1989



## Mapping An International Investment Strategy

## 1988 Proxy Season Established New Force In Corporate America

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• Plan Sponsors •
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A Publication Of
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**About The Cover:** The U.S. pension funds are taking a closer look at foreign investment opportunities.

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# Mapping An International Investment Strategy For The 1990s

***While most of the money going overseas has been for equity investment, a large portion is being devoted to fixed income.***

**BY GAVIN R. DOBSON,** Vice President and Portfolio Strategist
Kemper International Fund, Chicago

The case for international investing has often been made. In fact, in dollar terms, there has not been one quarter in the 1980s in which the Standard & Poor's 500 has not been beaten by at least one foreign market, in dollar terms. Additionally, there has not been one year in the last 30 years in which the U.S. stock market has been the best-performing market in the world.

Today, the U.S. stock market represents 29 percent of the total world capitalization. In 1970 the market represented 66.3 percent of the total world capitalization. While many smaller markets are now coming on stream for investment, the United States is retiring a significant percentage of equity through mergers, leveraged buyouts and stock buy backs. Thus, these other markets are still in the first flush of their stock market era.

Additionally, many foreign companies are world leaders in their fields. Therefore, it is important to be aware of the foreign competition even when constructing a U.S. portfolio. After all, the largest food company in the world is Swiss (Nestle), the largest consumer electronics company is Japanese (Matsushita), the largest advertising firm is British (Saatchi & Saatchi), and the largest power engineering firm is Swedish (Asea-Brown Boveri).

Also, the international bond markets can produce excellent dollar-adjusted perfomances over time. According to Salomon Brothers, New York, the U.S. government bond index rose 7.04 percent in 1988. However, the Canadian bond index rose 19.41 percent in U.S. dollar terms and the Australian bond index 28.79 percent.

The Salomon Brothers currency-hedged index showed returns of 8.88 percent for Deutschmark bonds, 10.27 percent for Yen bonds, 9.28 percent for Dutch Guilders and 15.04 percent for French Franc government bonds. These results indicate that a combination of hedged and unhedged portfolios, in addition to a foreign fixed-income portfolio, can produce excellent dollar-adjusted performance.

Indeed, this fact is being recognized by investors. Since December 1980, U.S. pension assets overseas have grown from $6 billion to $57 billion (December 1988). And InterSec estimates that this figure will reach $70 billion by the end of this year.

In the past, corporate pension funds were the main investors overseas. In most cases, these corporations (Amoco, IBM, etc.) were multinationals that were familiar and comfortable with the concept of international markets.

In contrast, a significant number of public and private funds now invest part of their pension assets overseas. Funds as diverse as The Philadelphia Municipal Workers, Colorado Police and Fire, The Rhode Island Retirement System and the Illinois Teachers Retirement Fund have committed funds overseas.

While most of the money going overseas has been for equity investment, a significant portion is now being devoted

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to fixed income. For example, the New York Employees devoted more than $200 million to a passive overseas bond manager last year and the New Hampshire Retirement System devoted $30 million to global bond management.

Meanwhile, corporate pension funds are steadily raising their international exposure as well. Pacific Telesis, Pacific Power & Light, Libby-Owens-Ford, Fort Howard Paper, Baxter Travenol, Conrail, Unocal, Shell, Nalco, ITT and Maytag added international managers in 1988.

Indeed, there is no question that the long-term trend of internationalizing U.S. pension funds is gathering speed. However, it will be a long time before U.S. pension funds approach the percentage they have invested overseas to that of their foreign counterparts. For instance, a typical British pension fund has 21 percent invested overseas, while a typical U.S. government or municipal fund has 1.4 percent invested in foreign markets. While there is a long way to go, there is every reason to be positive that a massive amount of U.S. pension fund money will go abroad in the next 10 years.

This trend is expected to redress the balance sheet of the United States. As interest payments and dividends are remitted back to the United States, they constitute an increasing "invisible export" for the United States that significantly helps the "debtor nation" status of the country.

With the possible exception of Japan, specific investment opportunities for the 1990s look optimistic for the United States. There is no question that Japan has been the financial phenomenon of the 1980s. While the U.S. equity market capitalization has sunk from 66.3 percent in 1970 to 29.1 percent in 1988, Japan has risen from a mere 4.6 percent to an astronomical 44.1 percent of the world's market capitalization. Indeed, Japan has been one of the best "buy and hold" investments of the 1980s.

But what about the 1990s? In 1980, the Nikkei Dow Jones Index was at 7000. Today it is at 30500. It is unlikely that a similar performance spurt will occur in the 1990s. It is more likely that the law of gravity will begin to operate in Tokyo, and that other markets will experience superior performance.

Of particular interest outside the United States are two specific areas: Europe and other emerging markets. The deregulation of financial, fiscal and national structures that is taking place in Europe is going to keep rolling for a number of years. This will open pockets of inefficiency and financial opportunities for investors.

Already pan-European takeover activity is galloping along, as companies position themselves for 1992 and beyond. Interestingly, non-EEC companies are being as aggressive in Europe as EEC companies. For example, 3M (U.S.) bought Spontex (France); Echlin (U.S.) bought Quinton Hazell (U.K.); Atlantic Richfield (U.S.) bought Tricentrol (U.K.); Electrolux (Sweden) bought Zanussi (Italy).

In addition, the influx of outside capital to enable non-EEC companies to manufacture and compete within the EEC will probably accelerate well into the 1990s. In this area, companies such as Toyota, Nissan, Ford and GE are well-positioned.

*Photograph by Jerry Hoy, Double Vision Inc., Atlanta. The map is a copyright of American Map Corp., New York, No. 19305.*

All this activity suggests strong financial markets in the 1990s. As a result, an international portfolio should not be underweighted in Europe.

In terms of other emerging markets, there are various categories from the highly investable like Korea, Thailand and Malaysia, to the long-term hopes like India and Zimbabwe. In many of these markets, a continuing maturity can be seen as these countries evolve into front-line investment havens. The criteria for this accolade would include: the

absence of foreign exchange controls; efficient and honest settlement systems; a commitment to capitalism; a non-bureaucratic, but well-policed market; liquidity; and marketability.

The trend with most emerging markets in the 1980s has been that a tightly controlled closed-end fund has been launched as the first access by foreigners to the markets. Thus, the Korea Fund, Chile Fund and India Fund serve as their respective market flagships.

In the 1990s, many emerging markets can be expected to open as their economies mature. This could lead to some spectacular performances. As far as pension investment is concerned, the long-term rewards for the early investors will be significant. Yet, it is doubtful that the majority of pension funds will participate.

Overall, there is a positive outlook for U.S. pension fund investment internationally in the 1990s. Historically, international investment has been a sound choice with excellent diversification characteristics and good performances. It is likely that with the worldwide deregulation and financial cooperation taking place, the international markets, on the whole, will be a promising investment for pension funds in the 1990s.□

# TABLE 2

## Total Returns In U.S. Dollars For The Month Of October And Nov. 1 - Dec. 31, 1987

| | OCTOBER | NOV 1 - DEC 31 |
|---|---|---|
| United States | (21.2) | (2.1) |
| Canada | (22.0) | 4.9 |
| United Kingdom | (21.5) | 7.2 |
| Germany | (17.6) | (7.8) |
| France | (18.4) | (1.9) |
| Switzerland | (17.6) | (3.5) |
| Belgium | (18.9) | 2.0 |
| Italy | (12.1) | (2.1) |
| Sweden | (17.5) | (6.1) |
| Norway | (27.9) | (15.5) |
| Denmark | (7.5) | 8.0 |
| Spain | (20.6) | 13.4 |
| Austria | (9.4) | 8.4 |
| Netherlands | (17.4) | 0.1 |
| Japan | (7.5) | 5.4 |
| Hong Kong | (43.4) | 5.6 |
| Singapore | (41.3) | 7.5 |
| Australia | (44.5) | 14.1 |
| Ranking Of U.S. Market | 12/18 | 13/18 |

Source: Morgan Stanley Capital International

# TABLE 1

## Annualized Country Index Total Returns

**Equity Markets - U.S. Dollars**

| | 1960-1970 | 1970-1980 | 1980-1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|
| United States | 4.0 | 8.0 | 14.9 | 17.4 | 5.1 | 15.8 |
| Canada | 5.0 | 11.9 | 5.5 | 10.7 | 14.6 | 18.0 |
| United Kingdom | 2.5 | 11.0 | 13.0 | 27.1 | 36.5 | 7.1 |
| Germany | 1.3 | 8.8 | 24.5 | 37.2 | (23.4) | 23.1 |
| France | (0.7) | 9.2 | 13.1 | 80.7 | (12.6) | 40.2 |
| Switzerland | 5.3 | 10.8 | 15.5 | 34.3 | (8.8) | 7.1 |
| Belgium | 0.6 | 13.0 | 22.6 | 83.9 | 10.9 | 57.9 |
| Italy | (1.6) | 0.3 | 14.1 | 109.4 | (20.8) | 12.5 |
| Sweden | 2.4 | 8.1 | 26.4 | 66.7 | 2.7 | 49.3 |
| Norway | 5.4 | 14.4 | 13.4 | (1.7) | 6.3 | 43.3 |
| Denmark | (0.2) | 12.1 | 17.8 | 2.0 | 14.0 | 4.0 |
| Spain | 11.1 | (0.1) | 10.2 | 123.0 | 37.8 | 14.2 |
| Austria | 3.8 | 11.9 | 13.3 | 35.2 | 2.7 | 1.1 |
| Netherlands | 2.1 | 11.5 | 20.1 | 42.3 | 8.2 | 15.5 |
| Finland | — | — | — | — | — | 14.3 |
| Japan | 5.6 | 18.4 | 19.3 | 99.7 | 43.2 | 35.5 |
| Hong Kong | N/A | 28.6 | 0.1 | 56.1 | (4.1) | 28.0 |
| Singapore | N/A | 22.8 | (5.9) | 45.2 | 2.3 | 33.3 |
| New Zealand | — | — | — | — | — | (12.3) |
| Australia | 6.5 | 7.9 | (0.6) | 43.8 | 10.3 | 38.1 |
| Ranking Of U.S. Market | 7/16 | 15/18 | 7/18 | 15/18 | 10/18 | 12/20 |

Source: Frank Russell Co.